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Central Intelligence Agency

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DIRECTORATE OF INTELLIGENCE

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Prospects for US Exports To Hungary and Poland 25X1

Summary

The climate for US exports to Hungary and Poland will remain poor unless these countries can overcome their own financial difficulties or receive Western aid. Even then, US firms will have to provide credits or concessionary financing. Also, US products may find a market if they help these countries earn more hard currency or save it by reducing their own imports. 25X1 25X1

Both countries will be keenly interested in forming joint ventures to acquire Western technology and expertise while saving hard currency. Both countries--particularly Hungary--already have the most liberal joint venture laws in Eastern Europe. Nonetheless, they still have a long way to go in improving their business climate before becoming competitive with the Newly Industrializing Economies (NIEs). 25X1

Sales to help develop Western tourism and management consulting offer US business interests the most potential. Other possible markets include: aircraft, telecommunications,

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health and environmental equipment, material-handling equipment and computer software. There is little opportunity, however, to sell non-agricultural raw materials for hard currency. 25X1

Discussion

Market Potential

Representatives of the governments of Hungary and Poland will tell the Secretary of Commerce during his forthcoming visit of their regimes' desire for a sharp increase in trade with the US. They will express their view that COCOM restrictions have prevented them from buying as much from the US as they would like. They will also complain that US markets have not been receptive to their export offerings. 25X1

In reality the greatest limitation to US exports is the ability of these regimes to afford them. Both countries face major hard currency shortages, high debt payments, and possible IMF-imposed austerity programs. Their export potential is limited because their producers cannot compete with the NIEs in terms of price and quality. 25X1

Trade

This poor financial condition means that the best US opportunities for straight trade deals exist when:

- Credits are provided at favorable terms or other creative purchase arrangements are arranged. Warsaw and Budapest prefer countertrade deals to pay for hard currency exports but the challenge for US firms is to find markets for the low-quality Polish and Hungarian products they would receive in return.

- The US product could be used to develop a domestic-produced good currently supplied by hard currency imports. For example, the sale of machinery to develop a domestic capability to produce high-grade plastics would ultimately allow reduction of plastic imports.

- The US product would help increase their own hard currency export capacity. For example, machinery for packaging might allow Poland and Hungary to become more competitive in foreign markets for processed foods.

- The trade deal involves both West European and US participation. The East Europeans over the years have developed special trading relationships with several countries, particularly West Germany, and are particularly keen to preserve these relationships with EC-92 lurking in the future. 25X1

Joint Ventures

The prospects for increased joint venture activity appears more promising than straight trade deals because the Western partner generally provides most of the hard currency. Both countries, particularly Hungary, have legislated new joint venture laws the last few years in an effort to attract more foreign investors. Budapest, which allows joint ventures in most sectors of the economy including banking, permits up to 100 percent foreign ownership, full repatriation of profits, simplified bureaucratic procedures, and relatively favorable tax rates including tax holidays in certain areas. Warsaw, which permits joint ventures in food processing, hotel construction, and manufacturing, has more restrictive laws, higher taxes, and mandatory conversion of a portion of hard currency earnings into nonconvertible zloties. 25X1 25X1

Although these countries come off favorably when compared with other East European countries, we do not want to gloss over the difficulties that place them at a disadvantage with the fast growing less developed countries. For example:

o Labor costs. When these costs are adjusted to a productivity basis, labor in Eastern Europe is probably more expensive than in the East Asian newly industrializing economies.

o Consumer orientation. East European partners concentrate on production quotas more than competition in price and quality.

o Inconsistent goals. The Poles and Hungarians are mostly interested in ventures that will increase their exports in Western markets. The Western partner, on the other hand, wants to gain access to Bloc markets--rather than compete in the West against their own subsidiaries--and manage some sales in hard currency which it may repatriate. The Hungarians hope to resolve this inconsistency by increasing their hard currency trade with Moscow so they could act as a bridge to the Soviet market.

o Unsettled political situation. The current unstable political and economic situation in Poland and to a lesser extent Hungary will discourage Western investors. In addition Western businessmen are particularly concerned about how far Moscow will allow political and economic reforms to go before intervening. 25X1

Best Opportunities by Sector

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US investment opportunties in Poland and Hungary are limited by these countries' lack of hard currency. Assuming sizable amounts of foreign funding become available through direct assistance or generous debt rescheduling arrangements, we can identify some areas where US firms have a chance to compete. We believe the service sector--mainly tourism and management consulting--is the most promising for the US since it does not involve COCOM-technology controls, is extremely rudimentary in these economies, and has the potential to produce hard currency earnings. Certain types of machinery and agricultural products offer some, but limited potential. There is little chance of the US penetrating the market for raw and semi-processed industrial materials. 25X1

Tourism and Management Consulting

Both countries might be interested in US assistance in developing its tourist industry for Westerners. Although Poland has long talked of encouraging the development of tourism, relatively little has been done and infrastructure and services remain poor. In contrast, Hungary is the Bloc leader in tourist development and receives the most tourists in Eastern Europe. Despite the advanced state of its tourist industry, Hungary attracts mostly Eastern Bloc tourists who use soft currency, but Budapest's desire to increase the number of hard currency Western visitors creates opportunties in the hotel, airport, and other tourist services sectors, as well as in the construction and management fields. In addition, if the proposed 1995 World's Fair in Budapest goes ahead, a lot of new infrastructure will be required. 25X1

Management consulting services may be increasingly in demand as these governments try to modernize their industries and restructure the economies. These changes will cause considerable disruption and the East Europeans will seek Western advice over how best to implement technical changes and adapt Western management techniques. Last November, with the assistance of US and Western universities and corporations, the International Management Center opened in Budapest. The institute provides provide American-style management, financing, and marketing instruction to managers from throughout Eastern Europe and the Soviet Union. Poland is also exploring the possibilty of setting up a similar center. 25X1

Machinery and other Quality Goods.

The COCOM approval of Airbus aircraft sales to East Germany last year, the first sale of Western aircraft to Eastern Europe since the mid 1970s, and attempts by Poland and Hungary to replace their noisy, fuel-inefficient Soviet aircraft with Western aircraft provide a modest opportunity for US exporters. Traditionally these countries have relied on Soviet-produced planes but problems in the aviation industry discourage replacing the fleet from their usual source. Hard currency shortages have forced the East Europeans to lease instead of buy aircraft and will help to limit purchases to only a few aircraft, largely for use on hard currency routes to the West. Already, Hungary has leased-purchased 3 Boeing 737 aircraft and Poland has leased 3 Boeing 767s. Presumably if Western tourism picks up, so will their demand for Western aircraft. 25X1

The telecommunications networks in Poland and Hungary are of 1950s vintage and are woefully inadequate for meeting the needs of a country hoping to participate in the world economy. Hungary received a World Bank loan to improve its network, and Poland could also benefit from an upgrade. The US might compete for this market, but producers from several other countries are competing aggressively to maintain sales in a shrinking global telecommunications market. 25X1

Health equipment and medicine are sorely needed in Poland and Hungary to remedy deplorable health conditions, such as the spread of diseases due to shortages of disposable needles and medicine routinely available in the West. Also, they need to learn how to better treat cardio-vascular diseases, one of the most serious health problems in the region. As the populace in these countries get a larger voice in their government, public health could become an important political issue; for example, male life expectancy is declining in Hungary. Shortages of medicine are particularly acute in Poland, where people frequently die of minor injuries because of primitive or nonexistent medical equipment, unsanitary conditions, or lack of medicine. 25X1

As these economies modernize, demand for material-handling equipment and computer software should increase substantially. Much of the transportation of materials in many of these antiquated plants is still conducted manually or by using the most rudimentary intra-plant transportation. Improvements of technology in this area are essential for the regimes to boost labor productivity and become competitive in world markets. Computer software, an area in which the US has a competitive advantage, will also increasingly be sought as Budapest and Hungary attempt to modernize industry and use computer-controlled machine tools as well as other computer-aided manufacturing and design. 25X1

Supplying antipollution equipment can provide the US with a visible means for improving the lot of the average citizen. Although East European governments have long given little priority to solving their environmental problems, growing political pressure brought on in part by the Chernobyl' nuclear reactor accident in 1986 have forced Warsaw and Budapest to address the issue. However, the East Europeans count on Western financial assistance because they cannot afford to buy substantial amounts of pollution cleanup technology. They want to avoid spending hard currency and receive outright grants of equipment and technology or concessionary loans from Western countries by playing on West European desires to curb transnational pollution. Since most pollution-abatement equipment

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is not COCOM-controlled, sales could benefit the US without giving away sensitive technology. 25X1

Concerns about environmental damage have put nuclear power safety equipment in greater demand in Hungary, where the Paks reactor is under construction. This probably will not become a market in Poland, because there is doubt the sole nuclear plant under construction at Zarnowiec will be operative any time soon. In Hungary, the US could provide safety surveys and analysis, inspection services, systems analysis, construction, operations consultations, and project partnerships. With the exception of certain computer programs and equipment, most safety enhancement equipment and techniques would not require special COCOM approval. 25X1

Another area of possible sales is any equipment that would help these economies use energy more efficiently, particularly in the energy-intensive steel, aluminum, cement, and chemical industries. Although Warsaw and Budapest generally can obtain energy from the USSR without expending hard currency, Moscow persistently refuses to increase the amount of oil it will provide and insists on a high level of East European investments in the Soviet gas industry to get more of that fuel. Poland and to a lesser extent Hungary also use highly-polluting coal, and would benefit from technology that reduces the need to burn coal. 25X1

Other Products

Agricultural goods represent moderate opportunities. However, both US and total sales have plummeted in recent years, with the West European share of exports rising markedly. Favorable pricing by the West Europeans, who are trying to dispose of their own agricultural surpluses, and geographic proximity have hindered US sales. The main US opportunties in this area may be grain and soybeans. Decontrol of agricultural prices in Poland could boost demand for US grain as farmers try to increase livestock herds. Also, some specialty processed foods might find their way into stores if regimes try to boost consumer morale. We believe such sales will remain small, however, and the regimes will be more interested in acquiring the ability to produce these items domestically. 25X1

We believe there is virtually no opportunity for the US to sell raw materials and other low-quality semi-manufactured goods and machinery unless the product satisfies a limited market niche. The East Europeans can already obtain these goods from the USSR and each other without expending hard currency. Now that both Poland and Hungary are in the unenviable position of running soft currency trade surpluses with Moscow, each country is looking for Soviet products they could use. Moreover, these countries can provide many of these goods internally and will try to do so to protect jobs in the event of economic restructuring. Finally, they can obtain some

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of these products through barter exchanges with less developed countries. 25X1

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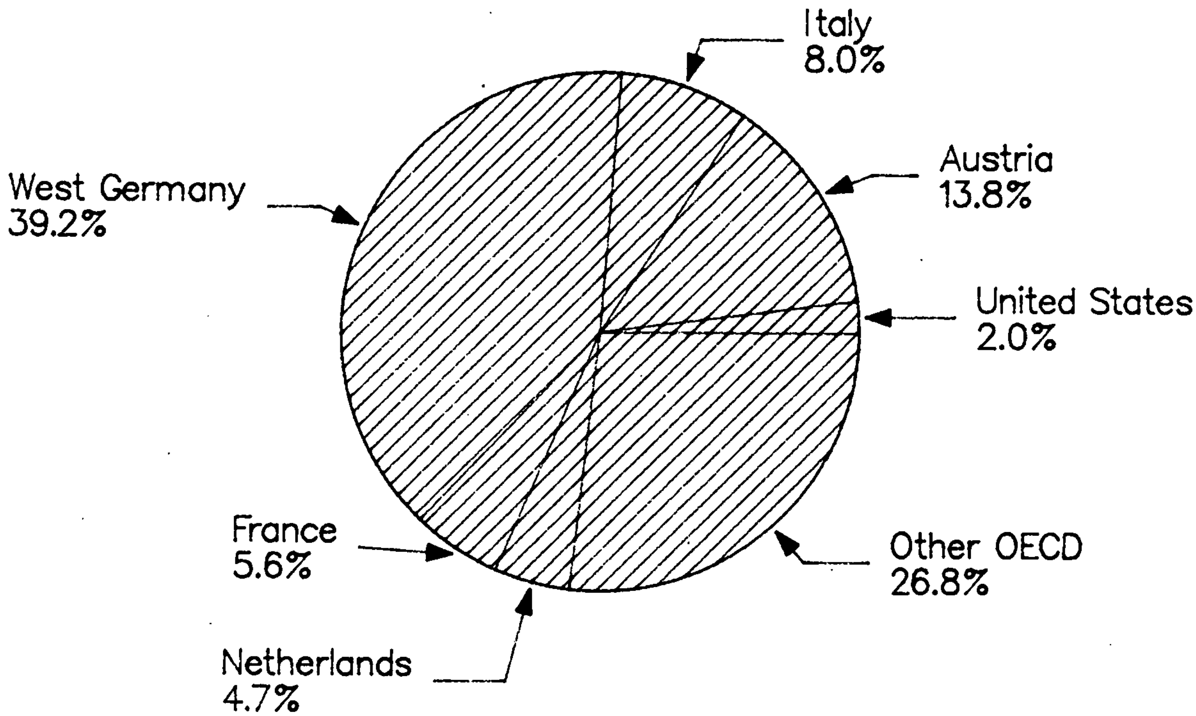
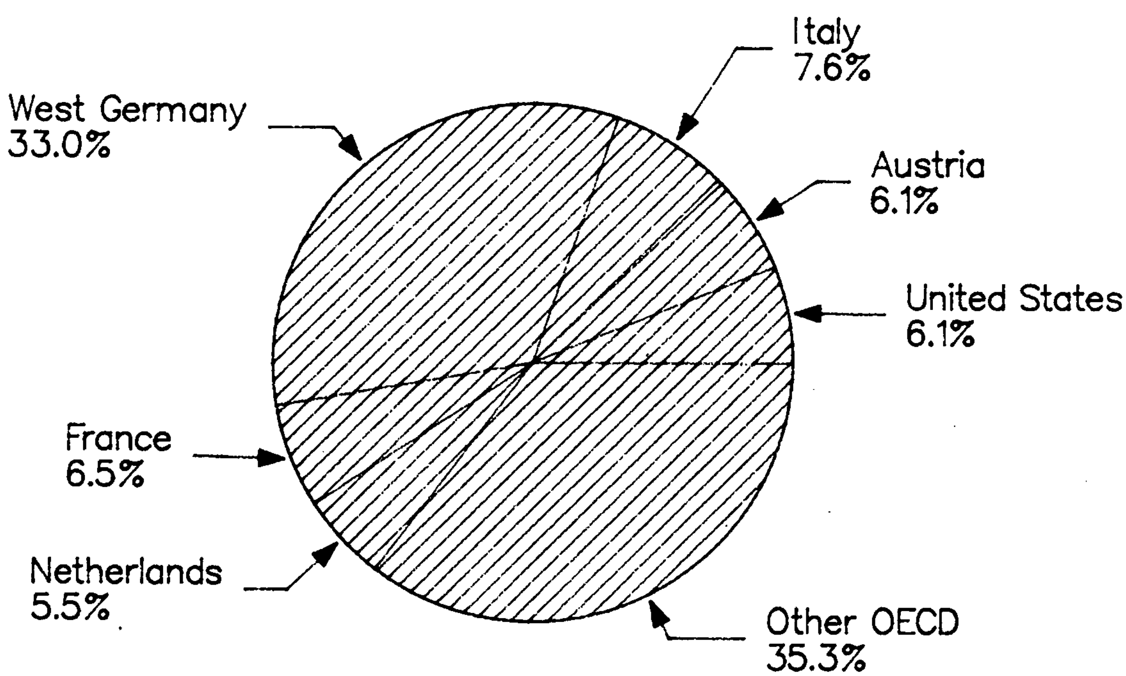
OECD Exports to Hungary and Poland, 1988

Market Share to Hungary

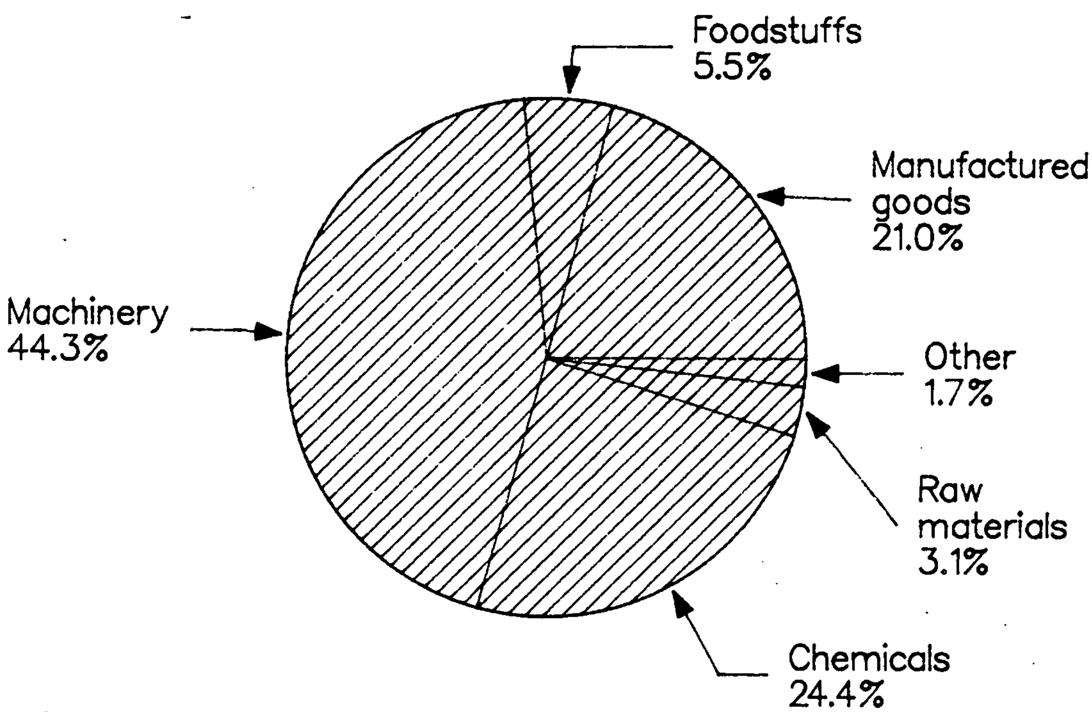


Market Share to Poland



Composition of US Exports to Hungary and Poland, 1988

Hungary



Poland